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C O N F I D E N T I A L SECTION 01 OF 02 KATHMANDU 000382

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SUBJECT: INDO-NEPAL CROSS-BORDER ENERGY TRADE STAGNATES

REF: KATHMANDU 314

Classified By: DCM Robert K. Boggs, for reasons 1.5(b) and (d).

1. (C) SUMMARY: Nepal's Minister for Water Resources Dipak Gyawali is sharply critical of India's policies on cross-border energy trade. He told us that he believes New Delhi focuses on the strategic aspects of water and energy to the exclusion of economics. Despite Nepal's current power surplus, Gyawali understands that Nepal will need to develop storage capacity in the future, in addition to slated run-of-the-river projects, in order to compensate for the high seasonal variability of water flows. He believes that joint venture models have the greatest potential for tapping Nepal's huge hydroelectric potential. In our view, India's resistance to joining South Asian regional initiatives is holding back the economic development of both countries and will impede national as well as donor-funded efforts to alleviate South Asia's poverty. Please see action request for Department and Embassy New Delhi in final paragraph. End Summary.

Water Resources Minister: India "Resistant to Economics"

2. (C) In the context of the recent SARI/E-sponsored Energy Information Administration (EIA) regional workshop in Kathmandu, SARI/Energy regional Coordinator, SARI/E Nepal coordinator, and Kathmandu-based Regional Environment Officer (REO) had a private dialogue with Water Resources Minister Dipak Gyawali and Secretary for Water Resources Keshab Chand. Gyawali (in typically outspoken fashion) sharply criticized India's policy on regional energy trading, saying that India was not just resistant to cross-border cooperation, but "resistant to economics." Gyawali stated that as long as India continued to view water and energy in purely strategic (and not economic) terms, there would be little progress in bilateral energy trading, and hence little opportunity for Nepal to develop its energy exports.

3. (C) When asked about Nepal supplying India's enormous future power needs, Gyawali pointed out that many Indian states provide free (or nearly free) power to certain favored customers, such as farmers. "If the price is zero, then obviously the demand will be infinite." The Minister cited a recent example where India had cut back on minuscule purchases of a few kilowatts of power in border areas. "So if they don't need five kilowatts, then don't tell me they need 40,000 megawatts."

4. (SBU) Gyawali conceded that although Nepal currently enjoys a surplus of supply for its grid, he expects the situation to turn around in 2-3 years. Nepal will need more run-of-the river projects in the 100-MW range, but also storage capacity to deal with seasonal variations. Joint ventures have the greatest potential for mobilizing the necessary capital, he thought. He said that Nepal needs to know more about both the irrigation and power systems of Uttar Pradesh and Bihar in order to estimate the scope for future cooperation with India. (The Minister left soon thereafter for an official visit to Patna, capital of Bihar.)

MEA Mandarins Circling the Wagons?

5. (C) In a subsequent conversation, managing Director General Janak Lal Karmacharya of the Nepal Electricity Authority (NEA, which comes under Gyawali's Water resources Ministry) told SARI representatives that Nepalese officials were still upset over the treatment meted out to the Nepali delegation at an aborted U.S.-Nepal-India hydropower partnership meeting in New Delhi in November 2002. (Note: the event was aimed at technical management improvement, not power trade. India boycotted the meeting, even though the Nepalis had already arrived.) However, he felt that we should take a long-term view, preparing the ground for future cooperation, but not expecting early breakthroughs.

6. (C) Department of Electricity Development Director General Lekh Man Singh told us that progress on the Arun III

cascade project, expected to provide a total of 402 MW, was glacial. The GOI still had to agree in order for Nepal to activate a USD 10 million Asian Development Bank credit to update technical and engineering studies which could eventually lead to ADB financing of the project. Further, Indian MEA officials had attempted to block the Australian West Seti project (750 MW) on the grounds that India should not pay foreign exchange for Nepali power when there were still possible hydro sites to develop in India. According to Singh, only a high-level intervention by Nepali officials with Indian ForMin Yashwant Sinha succeeded in getting this decision reversed. He believed that the MEA mandarins might try again to short-circuit the project when it gets to the Power Purchase Agreement (PPA) stage.

Divide and Conquer Strategy Appears Anachronistic

17. (C) COMMENT: India's preference for dealing with its neighbors on a bilateral basis extends well beyond the issue of energy, and certainly beyond USAID's regional energy program. There will be little immediate impact on the prospects for a regional power pool or bilateral work in the hydropower sector, since India has participated minimally in SARI/E programs aimed at this aspect to date. If one of SARI's objectives is, however, to engender a more productive atmosphere for energy trading negotiations between India and Nepal, much more clearly needs to be done. Fortunately, there is much more to SARI. From Nepal's perspective, SARI provides numerous other benefits in training and technical information sharing with regional counterparts with or without India. Further, such activities supplement our bilateral efforts. We therefore support SARI/E's continuation, although the focus on regional energy trading may need to be revamped in favor of sector reform initiatives. The door must be left open for India to re-think its bilateral-only approach.

The Emperor Has No Clothes

18. (C) COMMENT CONTINUED: However, we remain deeply concerned over India's apparent unwillingness to collaborate fully in regional efforts which stand to bring much-needed, long-term benefit to poverty-stricken Nepal. Indeed, indications are multiplying that India will resist participating in any forum organized by the U.S. that has only South Asian countries as participants. The hamstringing of Nepal's efforts to realize its enormous hydroelectric potential by its only market is a major obstacle to Nepal's development prospects. This is particularly costly at a time when low standards of living and lack of economic opportunity in the countryside are fueling an insurrection that is sending Nepal backward.

19. (C) ACTION REQUEST FOR DEPARTMENT AND NEW DELHI: There is a considerable U.S. investment to protect in this regional initiative. We believe the U.S. has a strong interest in promoting regional cohesion and alleviating South Asia's crushing poverty. It would therefore be in the U.S. interest to try to wean the GOI, especially the MEA, from its anachronistic insistence on bilateral approaches to regional problems -- which has long been a source of irritation to India's smaller neighbors, such as Nepal. Department and Embassy New Delhi may wish to consider how best to further the objectives of SARI and other USG-sponsored regional initiatives through a discreet but consistent dialogue with decision-makers in MEA and other GOI power centers.

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